Foreign Direct Investment: A Survey of Canadian Research

A.E. Safarian

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PREFACE

This study was prepared originally for a Round Table of Canadian and French economists held in Paris in December 1981. The Round Table was sponsored by The Canadian Economics Association and Le Centre National de la Recherche Scientifique, with the assistance of the Social Sciences and Humanities Research Council of Canada. This earlier version was given limited circulation by the Institute for Policy Analysis, University of Toronto, as Policy Study No. 82-5.

The present version has been substantially revised and updated. I was encouraged by John Curtis of the Institute for Research on Public Policy to undertake this revision and was aided considerably by his comments on the earlier version. An assessor for the earlier paper also contributed much to the final product. I am grateful also for research support from the Social Sciences and Humanities Research Council of Canada.

I am very conscious that a short paper cannot do justice to the outstanding contributions of Canadian economists to this topic. Omissions, as well as errors, are entirely my responsibility.

A.E. Safarian
June 1984

THE AUTHOR

A. Edward Safarian received a B.A. in political economy from the University of Toronto in 1946 and a Ph. D. in economics from the University of California, Berkeley, in 1956. From 1950 to 1955 he was a statistician with the Dominion Bureau of Statistics in Ottawa. From 1956 to 1966 he was professor of economics (and from 1962 to 1966, chairman) in the Department of Economics and Political Science, University of Saskatchewan. Since 1966 he has been professor of economics in the Department of Political Economy at the University of Toronto and is an associate of the University's Institute for Policy Analysis. He was Dean, School of Graduate Studies, University of Toronto, from 1971 to 1976.

Professor Safarian's main teaching and research interests have been various areas of public policy, particularly the economics of multinational enterprises. His major books are The Canadian Economy in the Great Depression (1958), Foreign Ownership of Canadian Industry (1966), The Performance of Foreign-Owned Firms in Canada (1969), Canadian Federalism and Economic Integration (1974), and Governments and Multinationals: Policies in the Developed Countries (1983).

Professor Safarian was a member in 1967 of the federal government's Task Force on the Structure of Canadian Industry and has acted as a consultant to the federal government on the economic

aspects of the Canadian constitution. He was president of the Canadian Economics Association in 1977-78, a member of the Ontario Economic Council from 1974 to 1981, and has been a member of the Canadian-American Committee since 1972.

SUMMARY

Foreign direct investment and multinational enterprises have played a major but controversial role in Canada. This study assesses that role as it surveys the theoretical and empirical research by Canadian economists on this subject. Some attention is also given to work on Canada by other economists. No attempt is made to cover systematically the research by other social scientists, including that by business economists, or the experience of the developing countries. Some of the work by non-economists is used, however, to expand on several policy questions.

The themes emphasized here are drawn from the relevant international economic literature. The major contributions by Canadian economists have been to the theory of foreign direct investment and to the overlapping questions of the macro- and micro-effects of such investment from a host country perspective. Some important policy questions are raised by the first general theme: Why, and to what extent, do oligopolistic multinational enterprises prefer to use subsidiaries to transfer their products and techniques, rather than markets or contracts with independent parties? One's assessment of the effects on social welfare depends on whether one regards the firm as an efficient alternative to imperfect markets for technology or as an addition to market imperfections.

The macro-economic effects largely depend on whether

appropriate taxation policies are followed. Detailed analyses of micro-economic effects show how foreign ownership affects industrial performance in Canada. A major debate has occurred on the extent to which inadequate economic performance results from foreign ownership, as distinct from industrial policies and other factors.

Most Canadian economists who have written on this subject tend to the view that economic welfare effects either depend on the circumstances or are positive on balance and that industrial policies are the key to the existence and the size of economic benefits. Some have important reservations about the long-term developmental effects.

Economic studies are less common on broader issues of public policy, such as income distribution and the effects of extensive foreign ownership on the capacity to implement public policies. Relatively few economists have addressed these issues with the precision they have brought to bear on other aspects of the multinational enterprise. The same can be said about economic analysis of the considerable number of policy instruments, such as the Foreign Investment Review Agency and the National Energy Program, that governments have used in this area.

During the 1970s many more Canadian economists addressed issues arising from direct investment, with important improvements in theory and testing. Still, economists have not paid enough attention to the relative decline of Canada as a host country and her significantly greater role as a home country for multinational investment.

ABRÉGÉ

L'investissement étranger direct et les entreprises multinationales ont joué au Canada un rôle considérable, quoique controversé. Pour tenter de définir ce rôle, on a choisi de passer en revue les recherches théoriques et empiriques effectuées par les économistes canadiens en ce domaine et de s'intéresser également aux travaux d'autres économistes sur le Canada. Si l'on a décidé de ne pas présenter d'analyse exhaustive des recherches d'autres spécialistes en sciences sociales, comme les études effectuées pas les économistes du milieu des affaires ou celles qui portent sur l'expérience des pays en voie de développement, on a toutefois fait appel à plusieurs travaux de non-économistes afin d'élargir le débat sur un certain nombre de questions de politique.

La littérature économique internationale consacrée à ce sujet a fourni les principaux thèmes de cette étude. À cet égard, la grande contribution des économistes canadiens est d'étudier la théorie de l'investissement étranger direct et les problèmes connexes liés aux effets micro- et macro-économiques d'un tel investissement dans la perspective du pays d'accueil. Le premier thème général soulève d'importantes questions de politique : Pourquoi, et dans quelle mesure, les entreprises multinationales oligopolistiques préfèrent-elles utiliser leurs filiales pour transférer leurs produits et leurs techniques, plutôt que de créer des marchés ou signer des ententes avec des parties indépendantes? L'évaluation des effets d'un tel choix sur le bien-être

social dépend de la façon dont on considère l'entreprise multinationale, à savoir comme une solution de rechange efficace aux marchés de technologie imparfaits ou comme une addition aux imperfections du marché.

Le effets macro-économiques dépendent en grande partie de la poursuite d'une politique appropriée en matière de fiscalité. Pour ce qui est des effets micro-économiques, un certain nombre d'analyses approfondies ont mis en évidence la façon dont l'appartenance étrangère influe sur la performance des industries canadiennes. La question de savoir dans quelle mesure l'appartenance étrangère peut être la cause d'une performance économique déficiente, et cela, indépendamment des mesures de politique industrielle et autres facteurs, a fait l'objet d'un très vif débat.

La plupart des économistes canadiens qui se sont penchés sur ce problème tendent à penser que les effets du bien-être économique dépendent des circonstances, ou bien sont positifs au bout du compte et que l'existence et l'importance des avantages économiques reposent sur la poursuite d'une politique industrielle. Certains d'entre eux ont exprimé de sérieuses réserves quant aux effets de l'investissement sur le développement économique à long terme.

Les études économiques portant sur les plus vastes questions de politique d'État, telles que la répartition du revenu et les effets d'un très fort degré d'appartenance étrangère sur la capacité de mise en oeuvre d'une telle politique, sont beaucoup moins nombreuses. Relativement peu d'économistes ont en effet examiné ces problèmes avec la précision qu'ils ont apportée à l'étude des autres aspects de l'entreprise multinationale. On peut en dire autant de l'analyse économique d'un nombre considérable d'instruments de politique, tels que l'Agence d'examen de l'investissement étranger et le Programme énergétique national, que les gouvernements ont utilisés dans ce domaine.

Au cours des années 70, un plus grand nombre d'économistes canadiens se sont penchés sur les problèmes engendrés par l'investissement direct, ce qui s'est traduit par d'importantes améliorations en matière de théorie et de contrôle. Il n'en reste pas moins, toutefois, que l'étude du déclin relatif du Canada en tant que

pays d'accueil et de son essor en tant que pays d'origine de l'investissement multinational n'a pas assez attiré l'attention des économistes.

INTRODUCTION

This study surveys and assesses the recent contributions by Canadian economists to the theory and policy of foreign direct investment. By 'recent' I mean work in the 1970s and 1980s, although its roots are in work completed in the 1960s. The term 'foreign direct investment' includes issues surrounding multinational enterprises (MNEs). At times I will take a broad view of the terms 'Canadian' and 'economist' to include some work on Canada by non-Canadians and by non-economists.

I have tried to place this study in the context of the relevant international economic literature. Certain Canadian themes, however, receive more emphasis because of my familiarity with them, probably to the neglect of some work that deserves mention. Measurement problems figure prominently in some of the main issues noted, but, in general, methodological approaches are not reported in detail. Nor do I attempt to cover systematically the business literature on MNEs, on developing countries, or in the social sciences more generally. References will be made to some of these studies, however, in developing the major themes.

The issues covered can be noted briefly. Chapter 1 deals with the theory of foreign direct investment. The major question considered is why parent companies use the organizational form of the subsidiary to transfer their techniques. There are alternatives, after all, that parent

companies also use and that many governments prefer: specifically, markets (such as exports) and contracts (such as licences) with independent parties. Some time is spent developing these themes since important policy issues depend on just how substitutable these three organizational forms are in practice.

Chapter 2 examines the effect of foreign direct investment on economic growth and on the balance of payments. Here it is emphasized that estimates depend crucially on the types of assumptions noted in Chapter 1. Also discussed is the lack of attention to Canada as a home country for MNEs.

Chapter 3 concentrates on micro-economic effects, especially the effects on industrial structure and the performance of a firm in terms of its exports, imports and research and development (R&D). I contrast two interpretations: one set of studies emphasizes the effects of industrial policies on all firms, wherever owned; the other group emphasizes foreign ownership and control for the observed performance results. The difference is critical to the types of policies one is likely to recommend.

Chapter 4 considers social and political aspects of a large MNE presence. The question of how this affects national independence extends, in some interpretations, to the broader issues of Canadian-US relations and of the interaction between governments and large corporations generally.

Chapter 5 deals with a variety of other policy issues, noting particularly the relatively few analyses of the Foreign Investment Review Agency and the National Energy Program. As will be seen, macro- and micro-economic effects overlap, as do economic and political effects.

The concluding chapter points out some of the gaps that remain in our understanding of foreign direct investment and of multinational enterprises.

1: THE THEORY OF FOREIGN DIRECT INVESTMENT

Many questions are addressed by theories of foreign direct investment: which firms go abroad, why they go to some countries more than to others, why they concentrate in certain industries, how they time their investments. Perhaps the central issue in theory is why parent companies use the organizational form of the corporation to transfer their techniques instead of the market or the various forms of contracts, such as licences. The relevant issue for economic policy is the welfare consequences of each form of organization. Where governments resist foreign ownership, whether for economic or for other reasons, the question then becomes how far they can succeed in providing substitutes for it through resident-controlled firms, markets, or contracts, while minimizing any negative effects on other policy objectives. Some would argue, as will be seen, that the long-run effects of such substitution on other policy objectives are not negative.

Internalization and Welfare

Important advances in the theory of foreign direct investment have come from the theory of industrial organization. One particularly promising approach has been to regard the growth of MNEs as a response to the benefits and costs to the firm of internalizing markets. When markets are imperfect, as they are said to be for certain types of knowledge, there is an incentive to bring the activities

involved under common ownership. When this occurs across national boundaries, MNEs are created. The 'intangible asset', which the firm finds more profitable to exploit by establishing a subsidiary than by other means, can be any aspect of its activity, from new product or process development to production, marketing, finance and personnel development. The key point is that it may be difficult to transfer this asset outside the firm, either because information markets work poorly or because it cannot be separated from the firm's personnel (Caves, 1982, 10). Transfer outside the firm may also allow less exploitation of rents on the asset, for example, by leading to faster imitation. From the firm's viewpoint, the possible advantages of internalization compared with markets and contracts can include the development of internal futures markets, the use of discriminatory pricing, the avoidance of the costs of bilateral bargaining, the elimination of buyer uncertainty, and the use of transfer pricing to minimize the effects of government intervention. Possible costs include the communication and administrative costs of internalization and the risk of political intervention against foreign ownership. Internalization is taken to the point where benefits equal costs (Buckley and Casson, especially 33 and 44). Another way to explore this set of issues is to study the economies of firm size and particularly of multi-plant operation; namely, economies of scale in marketing, assembly and allocation of capital, research and development, management, multi-plant specialization and investment staging, as explored by Scherer et al. (1975) among others. Where the plants are extended abroad significantly, an MNE is created.

In the present exploratory state of theory one must be careful not to insist on any single approach, as Dunning (1977) and Calvet (1981) have emphasized. Location theory, for example, clearly has a role to play as a firm decides which foreign markets to enter. Also, the view that economies of multi-plant operation, when extended abroad, are at the heart of the MNE, has been advanced and tested successfully by Eastman and Stykolt for Canada (1967, Chap. 4) and by Caves (1974) for Canada, but not for the United Kingdom (1974a). The former study will be examined in Chapter 3. Yet, the internalization approach has been a very fruitful way to look at issues in this area, both because it can be

interpreted broadly enough to encompass much of the work in this field and because of the close link to major work on the theory of the firm in general (see especially Williamson, 1975). A notable example of this approach is Caves' use of a 'transactional' model in his comprehensive survey of economic theory and statistical evidence applicable to MNEs (1982).

It was Stephen Hymer who first brought Coase's view on internalization and Bain's on barriers to entry to bear on the theory of foreign direct investment (Hymer, 1960, 1976). In the process he firmly divorced direct investment from the theory of capital flows generally, which respond to differing rates of return to capital, and put it in the context of oligopoly theory. In particular, he emphasized the distinct advantages an MNE could possess, outweighing those of local firms in their own market, and which could be exploited more profitably by direct investment than by licensing. Although his original study was critical of MNEs, Hymer couched his views in terms of conventional criticism of the possible negative welfare effects of oligopoly. His later work went well beyond this to look at political and social effects, particularly those related to the hierarchies of decision making between countries as a result of centralized planning in MNEs (Hymer, 1970).

The Hymer thesis has had a remarkable effect in Canada and elsewhere in stimulating work on direct investment. What needs emphasis here is that a fundamental, unresolved welfare issue remains at the centre of the internalization approach, whether used in the theory of the firm or in its application to direct investment and MNEs. The objectives of the firm may be advanced by such an approach to technology transfer, in contrast with markets or contracts, but the interests of a particular nation state, both home and host, may or may not be advanced. In addition, it is certain that the interests of different groups within any nation state will be affected unequally by direct investment and by the presence of MNEs, leading to very different reactions to the foreign presence.

Let us refer briefly to the studies that reflect this thinking. The earliest detailed study on Canada along these lines is by Bonin. Although he deals also with historical and macro-economic issues, Bonin emphasizes the determinants of the choice of direct investment over

other forms of technology transfer and the relation to concentration of industry, to product differentiation, and to other barriers to entry to an industry (Bonin, 1967, especially Chaps. 4 and 7). Richard Caves has undertaken a series of studies on Canada that will be referred to throughout this study. His seminal 1971 article placed the subject squarely in the context of industrial organization. Direct investment occurs in concentrated industries and reflects an attempt by the large firm to maximize quasi-rents on differentiated products in particular. Licences do not permit the rent to be collected as fully and can create competitors more quickly, while exports do not receive the same acceptance in local markets.

McManus attempted quite early a generalized statement of the theory of the international firm using Coase's work, an approach which, as already noted, has developed into the internalization theory of the international firm. He concluded that "the international firm would be chosen as the means of organizing production internationally in those industries in which both the interdependence among producers in various countries and the costs of co-ordinating their actions are relatively high" (McManus, 1972, 85).[1] His work on the international firm, it should be noted, is in the context of a more general attempt to explain the existence of firms as such, essentially by examining the costs of alternative organizations such as price systems (McManus, 1971, 1975).

The policy position towards which such views of direct investment lead is usually agnostic—the welfare effects depend on the circumstances. A stronger view of favourable effects is evident in the emphasis Johnson places on the incentives necessary to create knowledge, a view that builds partly on Vernon's innovative work on the product cycle and international trade and investment. Johnson sees direct investment as the extension abroad of an investment in knowledge superior to that available elsewhere. He believes the extension abroad could be done at a low marginal cost (a view since challenged by Teece and others), but there may be a substantial initial cost of developing new technologies and a need—in a system of private enterprise—for appropriate incentives. Temporary monopoly, as with patent protection, and slower diffusion are major ways in which these

incentives occur. Johnson points out but had no solution for the welfare dilemma involved here, in that new knowledge requires incentives but, once created, has the character of a public good that should be diffused as rapidly as possible, from a public viewpoint. He accepts that there are first-best justifications for restrictions on the volume of inflow (terms of trade effects and terms of borrowing) and second-best justifications for the effect on income distribution, but in general he believes "inward foreign direct investment cannot harm a country and may confer substantial benefits on it" (Johnson, 1970). More recently, Rugman has used internalization to examine the welfare effects of foreign direct investment in Canada, with generally positive conclusions (1980a). He has also argued that existing theories of foreign direct investment and multinational production through MNEs are, in the main, sub-sets of the general theory of internalization. With others he has recently explored various aspects of the theory, including its application to several industry studies (Rugman, 1980b, 1982).

The studies mentioned so far in this chapter contain at least two views of the large firm. One view suggests that social welfare outcomes can be negative or positive and must be considered individually. The other carries a presumption that its organizational form is generally beneficial to society and more certainly so if competition and/or competition policy keep a check on the firm's propensity to exploit barriers to entry.[2] These views will be examined at various points, but especially in Chapter 3.

Empirical Studies

A number of significant empirical studies, mainly on the determinants of US direct investment in Canada, generally support and spell out the theories discussed in the preceding section. Baumann (1975) and Wolf (1977), for example, found advertising and R&D associated with the degree of foreign ownership of an industry, and Caves (1974a) found R&D and multi-plant scale economies so associated. Globerman (1979b) confirmed all of these and other variables discussed in Chapter 3. English and Owen (1982) found product differentiation, sustained by various aspects of marketing, to be the key to the advantage enjoyed by the MNE, along with natural resource intensity in some industries.

Caves et al. (1980) used a very ambitious simultaneous-equation model of market structure and performance, using both Canadian and matched Canadian-US industries, for their tests. They found that multi-plant activity and R&D in the United States, and managerial and skilled employees in Canada, all work out well in predicting the degree of US ownership in Canada (pp. 85-6). Saunders' (1982a) tests also indicate that the pattern of foreign ownership of industry is partly determined by the foreign firm's ability to exploit intangible assets by Canadian production. In his research, multi-plant development in the corresponding US industry is the most important determinant of the extent of foreign ownership of Canadian manufacturing, but managerial resources and relative labour costs are also significant.

Canadian tariffs have long been emphasized as a determinant of inward foreign direct investment. Horst (1972) argues that parent company exports and subsidiary sales were alternative means to exploit the parent's advantages. In particular, the height of the Canadian tariff had a significant effect on the choice between these. Subsequent research (Orr, 1975) shows that the relationship was more complex than this. Caves has observed also that the cross-sectional studies used for these tests do not address what may be the more interesting point: the tariff may have been important to the subsidiary originally even if the current amount of protection is not important (Caves, 1982, 41).

Reuber and Roseman (1969) have studied mergers, as distinct from new investment. They found that US takeovers of Canadian firms are partly related to variation in merger activity in the United States, but also to the number of commercial failures and to the state of corporate liquidity in Canada. It should be added that acquisitions by Canadian-owned firms in Canada also follow the same pattern over time as merger activity in the United States (Government of Canada, 1978, 142). Bauman (1975) used a model based both on merger theory and on internalization theory to explain the industrial distribution of direct investment in Canada. His test, which explained about half the variation in the latter, led him to emphasize the need for an eclectic approach to explaining direct investment.

In a different vein, Rugman (1979) has argued that, in a world of imperfect capital markets, the international diversification of real

asset holdings may reduce risk and hence help account for the MNE. His tests suggest a more stable rate of return as the degree of multinational production increases. Wolf (1977) has argued that exports, foreign investment and domestic industrial diversification are part of a single diversification strategy, and he has tested this view and various associated ones for US manufacturing. Others, such as Caves (1975, 1980), have taken a similar position.

The internalization approach has been tested also by developing original data in order to analyze the international transmission of technology. Crookell (1973) has used case studies to analyze the transmission of technology by foreign-owned and Canadian-owned firms. In collaboration with Caves (1982), he and Killing have used interviews to examine technology licensing, within a model emphasizing imperfections in that market. Specifically, they consider the types of gains sought from participation in that market given such problems as uncertainty, opportunistic behaviour and the difficulties in appropriating rents. They also tested how far the terms of the licences reflect attempts to minimize these problems.

An extensive set of data for US parents and subsidiaries has permitted Vernon and Davidson (1979) to explore many propositions on the targets, speed and forms of transfer, specifically on new products. There is strong evidence in looking at this data over a period of thirty years that parent companies preferred to expand abroad in the lines with which they were most familiar at home and also to favour those countries with which they were already familiar. This pattern clearly fits a model where uncertainty and costs of information are minimized. Canada was strongly favoured in such expansion, as were parts of Latin America. Over time, however, greater product and geographical diversity occurred, with a significant shift away from these countries to Europe, Asia and Africa. Davidson and McFetridge (1984) have used this material to analyze in more detail the theory of the firm already noted, that is, that an international technology transfer is more likely to be internalized the greater is the relative cost of the market alternative, such as an arms-length licence. Their tests largely confirm that theory. For example, the probability of internal transfer is greater the newer or more radical is a technology. They also observe, however,

that the probability of internal transfer fell after 1970, suggesting more international competition in technology markets in recent years.

Much of the discussion in this chapter has been on the decision to establish or to expand a foreign-owned firm. In a world where MNEs are well established, another approach would be to look more broadly at their ongoing activities. Chapter 3 will consider one such aspect that has received much attention in Canada, namely the effects of the structure of an industry (including, especially, the country of ownership) on the economic performance of the firm. Another aspect, to be considered in Chapter 2, is the opportunity for transfer pricing, a distinguishing feature of an MNE.

In general, the issues of organization and strategy that underlie these and other aspects of ongoing MNE activities do not appear to have received as much attention in Canada as elsewhere. This study may give an impression of scarcity because it does not cover the contributions of those in business schools except insofar as they overlap closely with some of the issues discussed. One can note, for example, a comprehensive contribution by Rutenberg (1982) on the management of finance, production and plant location, marketing and personnel development within MNEs with different degrees of central direction. Rutenberg examines case studies within the relevant theoretical context to explore systematically the policies of MNEs. Case studies were also used in studies of larger subsidiaries prepared for the Royal Commission on Corporate Concentration and also in the work of Litvak and Maule for a number of Canadian MNEs (for example, 1975). Safarian (1966) and Garnier (1971, 1974) have attempted, for Canada and Quebec respectively, to determine statistically the division of decision making between parent and subsidiary and the determinants thereof. Still another aspect of MNE strategy is evident in Helleiner's initial tests (1977a, b), which suggested that labour on the one hand and MNEs on the other have become the two principal influences on tariff structures in Canada and in the United States. In particular, the MNE has succeeded in securing freer trade in those industries where it predominates. More detailed examination by Lavergne and Helleiner (1983), however, has not confirmed this view. Lecraw (1984) has examined statistically the policies of MNEs on equity ownership of

subsidiaries, a point central to internalization theory, in the context of the relative bargaining power of MNEs and developing host countries.

2: MACRO-ECONOMIC EFFECTS: ECONOMIC GROWTH AND THE BALANCE OF PAYMENTS

The sources of economic growth for a country are many and complex. Economists have long attempted to evaluate the contribution of increases in the labour force and of the stock of capital and technology over time, paying close attention to the effects on growth of both the quantity and quality of these inputs and their efficient use. There has been recognition also of complex and important social dimensions to the processes of growth, including the role that public policies can play in speeding or impeding it. An open economy and a federal state add important opportunities and constraints to the achievement of growth, the directions it takes, and the distribution of its proceeds.

Contribution to Economic Growth

In his classic article, MacDougall (1960) drew attention to the contributions foreign direct investment can make to the sources of economic growth to the extent that it supplies capital through inflows or retained earnings; access to better techniques of production, distribution and finance; and scale economies and market access. These gains may appear as higher real wages or employment, reduced prices or improved quality of output, and increased tax revenue. The direct costs are the various forms of income paid abroad for this capital and technology: dividends, interest on intra-company debt, royalties for use of technology, management fees and so on. All of

these may not be paid continuously or at arms-length pricing, but in those cases they are reflected in the parent's equity in the subsidiary. It is important to note that where a subsidiary is successful and where it retains some profit, there is an increasing liability to foreigners (as well as an increased domestic base) without any new capital inflow.

Two points deserve emphasis. First, these gains are potential, depending in part on the reactions of private agents of production (foreign and domestic) and on the wisdom of domestic policy. The taxes, for example, cannot be used as subsidies to foreign investment indefinitely if they are to be counted as a gain. The technical improvements must spill over into domestic firms if they are not to be reflected simply in the profits of the subsidiaries and the taxes collected by governments.[3] In these and other ways the economic environment in Canada is critical to the welfare outcome. Second, even if one can demonstrate there are net economic gains, this does not really address the question whether these gains can be achieved at a smaller direct cost in other ways, much less at smaller indirect costs.

Several attempts have been made to measure these net macro-economic benefits using neo-classical growth models. Penner estimated that net foreign investment (both portfolio and direct, and deducting Canadian investment abroad) contributed from 8 per cent to 20 per cent of the growth in per capita real income from 1950 to 1956. The range shown is due to different assumptions about the extent to which technical change is independent of investment, with the higher figure relevant when technical progress is implemented by additions to the stock of capital. He also argued, however, that the actual results depend heavily on the response of fiscal and monetary policies in Canada to the expansionary effects of capital inflows (Penner, 1966, 1970). Another estimate assumed that withholding taxes on payments abroad were gradually raised to the point where only domestic capital was used in production. Gross domestic product (produced in Canada) would fall 16.5 per cent, but gross national income (received by Canadians) only 3 per cent since income paid to foreigners would fall. Making rough allowance for other possible costs, it was suggested that two years of normal growth might be lost in the process (Helliwell and Broadbent, Neher, 1972). A third study yielded an even smaller

estimate of the effects of doing without net new capital imports, essentially because it assumed there would be a relatively easy shift to more labour-intensive products and industries (Powrie, 1978).

These studies may have uncovered some low-cost options for reducing reliance on foreign investment, including direct investment. One must note that they make some strong assumptions. All of them assume, with little or no comment, that one can buy on the market at no extra cost what one received through the MNE. As stated earlier, however, this is precisely the central question about technical development and transfer through firms in general and MNE's in particular. In Chapter 3 more will be said about the evidence of this in Canada. The latter two studies also assume that problems of unemployment and income redistribution effects can be constrained in the (gradual) move away from reliance on foreign investment. It is not clear that these results have made adequate allowance for the effects on Canadian industrial development of the implied limitation of outward direct investment.

It should be noted that, with some exceptions, such as the argument for an optimal tariff, economic theory supports free movement of goods and of factors, given the objective of maximizing global wealth and given competition and information. It is possible, however, to envisage situations where direct investment reduces world real income or the income of one or more of the countries involved, or both. Market imperfections arise either because of public policy, such as a tariff, or because of the market power of the firm. Brecher and Finlay (1983) show that where a tariff is imposed on imports of capital-intensive manufactured goods in a small open economy, an inflow of foreign capital leads to a net welfare loss if that capital is paid the value of its marginal product at domestic prices which include the tariff (see also Brecher and Diaz Alejandro, 1977). Where a tariff is imposed by the investing country, Markusen and Melvin (1979) demonstrated that a small capital movement, where ownership remained in the original country, could in some circumstances lead to a lower world real income and a lower income for one or both of the two countries considered. Moreover, when an MNE investment does raise world real income, the distribution of any monopoly profits determines

how the gains are divided between countries (Markusen, 1981). At one limit, where the MNE can enter the host country without cost and where all profits are repatriated, Markusen found that the host country can lose: it is the MNE and the home country rather than the host country entrepreneurs who capture the monopoly rents in such circumstances. Some of the implications of each of these arguments will be pursued further in Chapter 3.

Taxation and the MNE

The tax gain from inward direct investment is potentially large, because of provisions in the tax laws of many countries for a foreign tax credit. Where such provisions exist, taxes paid in a host country can be used as a credit up to the tax rate levied by the home country on income earned abroad. In addition, the tax on foreign source income is usually deferred until the income is paid to the parent firm. One result is that, in many developed countries, tax rates have converged. Brean (1984, Chap. 7) concludes that tax is not generally an important factor when a firm makes initial investments abroad. He states that the more important question is the effect on the growth of established operations, which, through reinvestment of earnings, accounts for the great bulk of direct investment. Both theory and various studies suggest a significant bias towards capital export because of the tax system. In addition, lower effective tax rates in Canada over time have encouraged US direct investment in Canada. Brean notes an estimate by J.D. Murray, using strong assumptions, that the bias towards US capital export may have increased the flow of foreign equity to Canadian manufacturing on average by 40 per cent to 50 per cent from 1964 to 1978. Brean also observes that the deferral provision of tax laws would lower the cost of reinvested earnings relative to other sources of financing, thus tending to favour capital intensive techniques and to confer an advantage over local firms.

Jenkins (1979) has used detailed estimates of effective tax rates and capital stock to assess tax benefits for Canada. His model assumes a constant real rate of return for capital over time, unlike earlier assumptions, such as MacDougall's, but consistent with his earlier measures (Jenkins, 1977). Two particular allowances in his estimates

should be mentioned. First, foreign capital inflow may affect the amount of foreign lending by Canadian residents: it may, for example, displace some host country investment that would otherwise have located in a sector. Jenkins assumes for purposes of estimation that foreign capital inflows have no effect on the amount Canadians lend abroad, and, alternatively, that such outflows are fully due to the inflows. Second, where Canadian tariffs induce foreign capital to enter Canada, imports are displaced. The customs revenues collected on such imports must be counted as a loss to Canada, since they now go to the foreign investor through higher prices on tariff-protected goods. For the period 1965-1974 Jenkins estimates that the tax gain to Canada was between 1.5 per cent and 2.5 per cent of GNP, depending on the assumptions used.

Grubel (1974) has addressed this issue from the viewpoint of the investing country, specifically the United States. He has estimated the private and social returns (the latter taking account of tax revenue) from US holdings abroad of bonds, stocks and direct investments. This is a partial estimate, as he notes, excluding other assets and mining and oil abroad, and also excluding US tax benefits from foreign investment in the United States. Foreign investment is socially profitable in this model if the foreign rate of return exceeds the domestic rate by a percentage larger than the foreign tax rate (given that US law and treaties allow taxes paid abroad to be deducted from tax liabilities to the US government). Although he regards his estimates as exploratory, he believes the evidence suggests that US investments abroad in manufacturing in the 1960s "do not clearly raise United States welfare and probably lower it" (p. 486).

Taxation of natural resource rents has attracted particular attention. This question had arisen apart from the price increases by the Organization of Petroleum Exporting Countries, as shown by Eric Kierans' critique (1973) of taxation in the natural resource industries of Manitoba. The enormous rents from petroleum and gas have, however, heightened interest greatly. As Wilkinson and others have pointed out (Roseman and Wilkinson, 1973; Wilkinson and Scarfe, 1980), an increase in prices for existing reserves, given the relatively low tax rates and high foreign ownership of petroleum, would yield a substantial gain to

foreign owners that either could be paid out or could increase future ownership of petroleum or other industries. They recommend either a revision of royalty rates and taxes for old oil or an increase in Canadian ownership, or both. The National Energy Program, which will be considered further in Chapter 5, reflects in part this concern.

The pricing of intra-firm sales across national boundaries offers the MNE opportunities to minimize taxes or tariffs and to limit the effects of some other national policies, such as controls on profits or on income payments abroad. Horst (1971) showed that an MNE which aims to maximize its global profit can minimize customs duties on exports to the host country by using, for example, a low transfer price, unless the tax difference between the host and home countries exceeds the tariff rate. Copithorne (1971) has developed a model in which he explored systematically some of the opportunities offered an MNE in transfer pricing and the problems for national governments in trying to cope with such practices. Quirin and Mathewson (1979) suggest, on the basis of simulations with a series of models, that the scope for transfer pricing is generally limited in Canada because taxes and tariffs give offsetting incentives. They believe it could be increased considerably, however, by moves to freer trade given the corporate tax systems used in Canada and the United States. Eden (1978) developed a framework for explaining profit-maximizing behaviour of an MNE given technical and cost constraints, product demands, and tax and tariff differentials between markets. By influencing transfer prices, these differentials can alter total corporate output and sales and the allocation among national subsidiaries. This model was used to predict that the change in the Canadian tariff from fair market value to the transfer value set by the General Agreement on Tariffs and Trade would accentuate the output effects of the decline in tariff rates resulting from the Tokyo Round. It was also used to analyze the effects on US-Canadian intra-firm trade of major tax changes in the two countries in the early 1970s (Eden 1983a, b).[4]

Balance of Payments: Home Country Effects

The effects of direct investment on the balance of payments are of particular interest for several reasons. As noted earlier in this chapter,

there is no term for repatriation, as there is for portfolio investment. Foreign liabilities grow if the subsidiary is successful and if earnings are retained, and the question of growth in the ability to finance transfers abroad becomes critical. Information and analyses of such effects on the balance of payments are important to analyses of the effects on the domestic income and on employment of inward or outward direct investment, or of policies that affect these. One important question that must be addressed in such studies is the extent to which foreign direct investment substitutes for, or supplements, investment in the home and host countries. Reuber and Roseman (1969) and Van Loo (1977) analyze part of this issue (see also footnote 10).

What this calls for is a comprehensive theoretical and empirical analysis of the effects of direct investment over time on the balance of payments, as developed by Hufbauer and Adler (1968) for the United States and by Reddaway and Associates (1968) for Great Britain. Unfortunately, no such comprehensive analysis exists for Canada. As a result, various selective and misleading interpretations have gained some currency, such as comparisons of direct investment inflows with the income paid abroad on the stock of such capital in Canada.[5] In recent years, however, the balance of payments effects have received increasing attention. Some writers have questioned the need for substantial capital inflows during a period of excess capacity. In part this reflected the debate in the last half of the 1970s on appropriate monetary and exchange rate policy in a period of slow growth and inflation, a debate anticipated by Penner's article in 1970. Wilkinson (1979) has put the argument into a longer-run context, challenging the view often heard officially that macro-policies must be designed to reflect a need for a sustained net inflow. He observes that, with unemployment, there is a domestic alternative to reliance on net imports of capital, but he goes beyond this point to explore the inter-generational welfare effects of such borrowing even at full employment, given the option of increased domestic savings. He is careful in both cases to state that the development of domestic alternatives involves important attitudinal and institutional changes. So far as direct investment is concerned, he points to some of the indirect costs (see Chapter 3) and suggests, without examination, that it

should be possible to develop substitutes and to distinguish when that is not feasible (pp. 20, 28).

Significant literature exists abroad on the effect of foreign direct investment and mulitnational production on the income, employment and balance of payments of the home country. There appears to be rather little analysis of this from Canada's perspective, though outflows of direct investment have exceeded inflows (net of retained earnings) since the mid-1970s. More significantly, according to preliminary estimates supplied by Statistics Canada, the stock of Canadian direct investment abroad rose from 25 per cent of the stock of foreign direct investment in Canada in 1974 to 54 per cent in 1983. Litvak and Maule (1981) have summarized the issues and given a profile of Canadian MNEs and of some of the policies that affect them, and Rugman (1984) has identified the firm-specific advantages of the major Canadian MNEs and related these to the organization and strategy of each. A few other studies, which will be discussed later, have considered Canadian policies towards developing countries as they relate to Canadian MNEs. Most major issues, however, await detailed theoretical and empirical research for Canada. Does the system of taxing foreign source income, for example, lead to more outward direct investment than is desirable from a home country viewpoint, as much writing elsewhere suggests (Hartman, 1980)? Does foreign direct investment substitute for exports, and, if so, to what extent (Swedenborg, 1979)? More generally, what are the effects on domestic employment of outward direct investment and the operation of one's own MNEs (Bergsten et al., 1978; Caves, 1982, Chap. 5)? Which transfer pricing issues are most important from the viewpoint of Canada as a home country? These are but a few of the important questions that remain to be answered for Canada.

3: MICRO-ECONOMIC EFFECTS: INDUSTRIAL STRUCTURE AND PERFORMANCE

Much of the emphasis in economic research has been on the ways in which elements of market structure affect the performance of the firm, especially the foreign-owned firm. A key issue is the extent to which the firm's performance reflects the nationality of ownership of the firm, as distinct from other elements of market structure, and what difference this should make for public policy. This issue has led to a vigorous debate in Canada over appropriate industrial policies. Underlying this debate are important theoretical points noted earlier, particularly whether one regards MNEs as mainly increasing market imperfections or responding to them, and whether the advantages an MNE possesses are pecuniary or real.[6]

Market Structure, Productivity and Competition

The classic study of market structure and performance in Canada, following on and extending that by Bain to an open economy, is by Eastman and Stykolt (1967). The model and the industry tests consider the effects of oligopolistic decision making within a market characterized by a number of factors, of which tariffs (Canadian and foreign) and a weak internal competition policy are especially important. A key effect is to encourage entry to industry at less than efficient scale and to encourage the multiplication of product lines. Entry into such a protected market at efficient scale would involve a

struggle for market shares, with uncertain and perhaps fatal results for the entrant. Market size is the most important determinant of the ratio of actual to efficient plant size in the industries studied. Failure to exploit economies of plant scale has increased unit costs of production and reduced the international competitiveness of manufacturing industries. This failure has contributed to the merger of Canadian-owned firms with foreign firms in order to acquire technical skills the former cannot develop because of their own size and efficiency. In brief, the fragmentation and high cost of much of manufacturing were attributed to an inappropriate industrial policy. Either freer trade or an effective competition policy were seen by Eastman and Stykolt as the keys to industrial rationalization.

In this model, foreign direct investment is more likely to be seen as an outcome, either of the tariff or of the need to merge in order to achieve extra-plant economies, rather than as a primary cause of the firm's performance. This way of looking at the problems of Canadian manufacturing has received a significant amount of support in other studies, beginning with early ones by English (1964) and Daly et al. (1968), and more recently by Gorecki (1976a), by the Economic Council of Canada's Looking Outward, by the background studies of Wonnacott (1975) and Postner (1975), by Daly and Globerman (1976), by Gupta (1979), and by Harris and Cox (1984). What distinguishes most of these studies is an emphasis on economies of scale, oligopoly, and some elements of a dynamic view of the relation between trade policy and technical change, with the result that the gains from freer trade are much larger than those in earlier models common in the international literature.

While it would take far too much space to do justice to these and related studies, two of the more recent studies, which used large data bases, can be noted briefly. Caves et al. (1980) analyzed the product diversity of companies within twenty sectors of manufacturing. They found that foreign-owned subsidiaries were more diversified than domestic firms on the average because of differences in company size and the degree of multi-plant operation. Once these were allowed for, nationality of ownership was not statistically significant (pp. 205-22).[7] They find also that foreign ownership tends to have a negative effect

on plant size relative to efficient scale (except in consumer's convenience goods), a result they attribute partly to the presence of foreign direct investment in protected industry (pp. 264-74). Baldwin and Gorecki have produced the most recent detailed studies of the determinants of plant scale, product diversity and length of production run in Canadian manufacturing. With some qualification they conclude that "our results are relatively powerful on the Eastman/Stykolt effect. Our results suggest high tariffs/high concentrations do result in 'excessive' diversity and shorter production runs, while foreign ownership has little measurable impact, either in general or in high concentration/high tariff industries" (1983b, 116).

The attempts to measure the effects of foreign-owned firms on productivity and related variables have shown a positive relation, but not uniformly. Saunders (1980) found that in the 1960s the physical value added per worker in Canadian industry, relative to the comparable US industry, fell as foreign ownership in Canada rose. Caves et al. (1980, Chap. 10) found a positive but weak relationship between foreign ownership and technical efficiency in Canadian industry. Shapiro (1980) conducted a detailed study of financial structure and performance in foreign and domestic firms in Canada. One of his findings is that US-controlled firms had higher profits than domestic firms, but this was not true for firms controlled overseas. MacCharles (1978) found that the cost of administrative organization was lower for foreign-owned than for Canadian-owned firms, a difference concentrated in the smaller Canadian-owned firms. Parts of the Baldwin and Gorecki study can be read to suggest more specialization by US-owned firms (1983b, 65, 109).

One of the potential benefits of foreign direct investment is a number of spillovers to domestic firms from subsidiaries. These benefits might come from sources such as improved competition in domestic industries, training of workers and management who move to other firms, and improved productivity in domestically owned firms as a result of a more rapid spread of technology. Whether these spillovers occur depends in part on the host country's policies and setting and in part on the effects of particular MNE investments. If the spillovers do not occur, the foreign firm captures the quasi-rents involved in its

particular advantages, subject to taxation by the host country on any increase in output.

Caves (1974b) reasons that the profit rates of domestically owned firms should be inversely related to the presence of foreign direct investment, other things being equal, if it were true that foreign direct investment improves efficiency. He finds only weak support for this view so far as Canada is concerned, possibly, as he observes, because available data on profit rates are such a poor measure of performance. Using labour productivity he obtains stronger results for Australia. Globerman (1979a) also uses labour productivity in domestically owned plants, adjusted for various other factors that could affect it, and relates this to foreign direct investment in the same industry. He found modestly stronger evidence than did Caves of the existence of spillover benefits in Canadian manufacturing due to the presence of foreign direct investment. Wilkinson also tested this concept, with results that contradict these findings. Using national data, he shows that the greater is the degree of foreign ownership of an industry, other things being equal, the less is the value added per worker in domestically owned plants. Any spillover benefits, he suggests, are outweighed by negative effects. The foreign ownership variables are no longer strong, however, when the tests are repeated with provincial data, where the larger number of observations reduces some of the statistical problems involved in such tests (Wilkinson, 1982). More fully specified models and better data are necessary if the effects of foreign direct investment on the productivity of Canadian-owned firms are to be analyzed by such methods.

The welfare effects of foreign direct investment and multinational production can be approached also by considering the effects on competition in an industry. As with the domestic theory of the large firm in concentrated industries, however, there is no a priori reason why one would expect a particular welfare outcome to prevail. Where barriers to entry are important, new foreign direct investment can be very effective in overcoming them. Where entry is by merger, however, the results on competition are less predictable, and the same is true of the behaviour of established MNEs. Although much can be said about particular aspects by adapting the literature of industrial

organization to this purpose, in the end an agnostic view appears to be the only safe one (Caves, 1982, Chap. 4; Caves et al., 1980, 377-79).

With that caveat, we can note some interesting findings on Canadian experience. Tests in other countries suggest that foreign investment and seller concentration are related. Such evidence has been found for Canada in that concentration in US industry encourages foreign investment in Canada (Caves et al., 1980, 87). The study by Rosenbluth (1970) can be interpreted as giving less support than other studies to the relation between concentration and foreign ownership within a country. Rosenbluth concludes that the size of a firm explains the prevalence of foreign-owned firms in concentrated industries and among the leading firms. Concentration and high merger activity, moreover, where they persist in his data, do so for firms controlled overseas rather than those controlled in the United States. Gorecki (1976b) found that domestic enterprises enter mainly the industries with low barriers to entry, while foreign enterprises enter those with low barriers and those with high barriers to the same degree. This finding supports the view that, where entry alone in considered, the MNE has some advantages. Later research, however, suggests that the response of domestic firms, by industry entry and exit, was stronger than the response of foreign-owned firms to the opportunities provided by growing foreign trade. This difference in response may reflect not only more scope for rationalization in the domestic sector but also some domestic penetration of the foreign-owned sector (Baldwin and Gorecki, 1983c, 120-24).

Foreign Trade, Research Capacity and Stunted Growth

There is obviously a range of issues on the performance issues of MNEs that might be studied. Two that have attracted particular attention in Canada are the effects on foreign trade and the effects on research capacity in Canada. These are closely related to theoretical issues touched on earlier: for example, to what extent can exports by the parent firm substitute for direct investment, and what are the effects of technology transfer through an MNE? Many current questions of industrial adjustment and development revolve around such issues. An early study explored these and other issues at some length, examining

the operations of foreign-owned subsidiaries and comparing them with domestic firms. One conclusion was that the average export and local research performance were not significantly different for domestic and foreign-owned firms, though foreign-owned firms did have larger imports (Safarian, 1966, 1969). These findings contrast with a number of studies of US direct investment in European countries, which suggest export and research performance may be superior to those of domestic firms (for example, Vernon, 1971, 158-62; 1977, 114). Generally, the findings are consistent with the studies by Eastman and Stykolt and others that emphasize the underlying economic and policy setting rather than the effects of foreign ownership as such. Indeed, Charles Kindleberger once observed that Canadian policies may have "emasculated" the MNE.[8]

This emphasis has been criticized from several perspectives. As early as 1962 Dehem ascribed "stunted" economic growth in part to the limited capacity of subsidiaries to exploit world markets, although he made no test of this. Raynauld (1971, 1974) prepared detailed estimates for Quebec in 1961 indicating that both size and labour productivity of the firm rose as one went from those owned by French-Canadians to those owned by English-Canadians to those owned by foreigners. Among other things, he challenged any implication in the above types of studies that, if nationality of ownership did not matter to welfare outcomes, neither did the development of local entrepreneurship. Kardasz (1972) and others also criticized the statistical methods and other aspects of Safarian's work.

The fundamental challenge to the conclusions of Safarian, of Eastman and Stykolt, and of related studies came, however, from the study by Levitt (1970) and the associated ideas in the Government of Canada study popularly known as the Gray Report (1972). The former used an argument familiar in low-income countries, especially in Latin America, namely, that a high degree of continuing dependence on imported techniques has created an environment in which entrepreneurial effort is permanently dampened. National political unity is itself threatened by the position of Canada vis-à-vis the United States wherein the US corporations treat Canada as a supplier of raw materials and as a market for manufactured goods and technology. The

Gray Report's central thesis is that subsidiaries are "truncated" through reliance on the parent abroad for many managerial and technical inputs, thus leading to important gaps in Canada's domestic capacities in these respects. Several studies prepared for the Science Council of Canada, notably that by Britton and Gilmour (1978), have argued along similar lines, particularly in relating Canada's trade deficit in end products to the presence of non-innovating subsidiaries. These latter studies have gone on to recommend such policies as subsidizing high-technology Canadian-owned firms and monitoring the inflow of technology.

These views have drawn attention to dynamics of the growth process that are sometimes neglected. They have not yet, however, been adequately tested. It has been suggested also that they place too much responsibility on the MNE for Canada's industrial problems and do not take sufficient account of other explanations (Safarian 1973, 426-28; 1979). As for the particular aspects of performance noted here, more recent data, and in some cases more sophisticated testing, have tended to confirm Safarian's earlier findings on exports and imports, but raised questions about that on R&D. Wilkinson (1968) confirmed that average export performance of subsidiaries and of Canadian-owned firms is about the same. McFetridge and Weatherby (1977, Chap. 2) found that exports were slightly greater for subsidiaries, but this reflected higher export performance in the primary sector: there was not a statistically significant difference due to ownership in manufacturing. In a study limited to the innovative manufacturing industries, Hanel and Palda (1981) found that firms under Canadian control tended to export more: this tendency weakened and was pre-empted, however, by variables that better expressed technological borrowing from the parent firms. The higher import propensity of foreign-owned firms was confirmed by Wilkinson (1968), by Britton (1976) and by Statistics Canada (1981).

The findings on research and development expenditures are mixed. Lithwick (1969) reached a conclusion similar to Safarian's. Globerman (1973) found that foreign ownership was associated with greater research intensity in technologically progressive industries, but that the situation was reversed where technological opportunities were less favourable. The results from Howe and McFetridge (1976) and

McFetridge (1977) indicate, however, that domestically owned firms spent more on R&D in Canada. These results held also for a more detailed test in their work on the electrical and chemical industries, but not on the non-machinery industries. A study of firms in five Canadian research-intensive industries also concluded that Canadian-owned firms had higher ratios of research spending to sales than the foreign-owned firms (De Melto et al., 1980; Economic Council, 1983, 41-2). The Economic Council presents some evidence that this difference may have appeared during the 1970s. Rugman (1981) has argued that internalization theory and evidence suggest that MNEs will concentrate R&D in the parent and that the subsidiary's R&D will fall short of the R&D of the parent and of independent firms of similar size. A recent study, however, of four research-intensive industries, using a more comprehensive Statistics Canada data base than those available earlier, found that differences in ownership did not affect the R&D expenditures of those firms where R&D is performed (Hewitt, 1983). Palda and Pazderka (1982), using comparisons with members of the Organization for Economic Cooperation and Development to establish norms, could find no relationship between foreign ownership and R&D expenditures in the seven industries they examined.

Such testing of average performance, while useful for some purposes, does not address a number of important issues. First, some of the studies referred to do not sufficiently attempt to explain why and to what extent each of foreign ownership and trade barriers, among other things, might account for industrial inefficiency. The Wonnacotts (1980) and Saunders (1982b) have both addressed these questions.

Second, the distribution about the average performance in such tests needs to be examined further. Safarian's early study, for example, examined the various restrictions on exports by subsidiaries, at one extreme, and the advantages of export through affiliates, at the other (1966, Chap. 4).

Third, the nature and effects of intra-firm trade have not been thoroughly studied in Canada, apart from selected aspects, such as transfer pricing. About half of US imports in 1977 entered through importing firms related by ownership (5 per cent of voting equity or more) to the exporting firms. These figures rise to much higher

percentages for a range of important industries in the case of imports from Canada (Helleiner and Lavergne, 1979; Economic Council of Canada, 1983, 95). More recent research suggests that such trade may not be nearly as significant nor growing as rapidly as was first believed, once one allows for petroleum imports, for the fact that much of US manufactured exports to subsidiaries are for resale, and for the special case of the trade of the Canada-US Autopact (Lavergne and Helleiner, 1983). Where intra-firm trade is significant, whether in exports or imports, the implications for policy can be important. For example, Goldsborough (1981) has examined the ways in which intra-firm trade may be less responsive than is arm's-length trade to changes in relative prices.

Fourth, the welfare aspects of increasing exports, decreasing imports, and increasing research and development expenditures in Canada need to be thought through more clearly, both in relation to direct investment and otherwise. Without further analysis of the types of imports and their uses, for example, it is difficult to know what to say of welfare aspects (MacCharles, 1982). It is in the work on R&D and direct investment, however, that some of the problems in welfare analysis stand out.

The debate on R&D and foreign ownership of industry has been too narrowly conceived by some of the studies discussed in this chapter. Both R&D spending in Canada and intra-corporate transfer of technology to Canada can confer benefits, and both involve costs. It is unlikely that generalizations about net benefits will be meaningful without fuller specification of the issues. For example, patent policy is also of considerable interest for an open economy with many MNEs, most to date on the inward side. Among other conclusions, Berkowitz and Kotowitz (1982) note that the desirability of having more domestic research by foreign-owned subsidiaries depends on ensuring that the patent rights and royalties accrue to those subsidiaries.

The Economic Council of Canada has sponsored studies that proceed from a broad perspective. The Council's studies emphasize the importance of both the generation and the diffusion of innovations, noting that R&D is only one aspect of a complex process (Economic Council of Canada, 1983, Chaps. 5-6). Some of the findings of interest

for present purposes may be noted briefly.

First, performance comparisons of Canada's R&D spending with other countries look better once one recognizes that some industries perform more research and adjusts for this, and better still if one regards access to R&D (rather than just performing it) as an asset (Palda and Pazderka, 1982).

Second, a path-breaking study of innovations in five industries has given a more optimistic view of Canadian technical activity than one might have derived from some of the work cited here, while noting the difference in the activities of foreign-owned and domestically owned firms. The foreign-owned firms did most of the process innovations, for example, and had longer pay-back periods. The two sets of firms were about equally involved in product innovations, but the Canadian-owned firms spent more on basic research for product innovations and got more spin-offs from them (De Melto et al., 1980).

Third, although MNEs use both intra-firm and arm's-length transfers of technology, they favour the former where new, sophisticated or expensive technologies are concerned.[9] This is quite clearly related to what was said in Chapter 1 about the uncertainty and cost of dealing with unrelated parties in such technologies, from the viewpoint of the theory of the multinational firm.

Fourth, the spread of innovation to Canada may be speeded up via subsidiaries. A study by Mansfield and Romeo (1980) of a sample of technology exports by US firms indicated that the average lag was six years for subsidiaries in developed countries, ten years for subsidiaries in developing countries, and thirteen years for transfer to joint ventures or independent licensees. The Council's studies on innovations suggest that a link with a parent or affiliate tends to reduce the lag in the spread of innovations compared with internal development of the technology or its acquisition outside the firm (Economic Council of Canada, 1983, 56-7; McMullen, 1982).

The Council believes, on the evidence of case studies, that technical change diffuses more slowly into and throughout Canada than in other Western developed nations, both for manufacturing and for services (1983, 61). If that is so, one must contrast this finding with the evidence that innovations diffuse faster through parent-subsidiary links.

Apart from possible gaps in the tests used in these studies, Canada may not have optimized the potential for gain offered by access to MNEs.

4: SOCIAL AND POLITICAL EFFECTS: POLICY IMPLEMENTATION AND INCOME DISTRIBUTION

The issue that most troubles many people about the MNE is the extent to which it reduces the power of a nation's government to implement policies in the nation's interests. An MNE with assets in various national locations, including important head-office assets abroad, and with some degree of overall co-ordination, poses a challenge to national decision making. Some types of policies are not feasible; the costs of implementing others will rise. The distinctiveness of the society itself may become difficult to retain, and sovereignty is thus reduced. How one assesses that result depends partly on one's view of gains in other respects.

One way to look at this issue is to examine particular policy instruments and to ask how they are affected by the presence of MNEs, given the various strategies they follow. Part of the literature on fiscal-monetary policy and the balance of payments under different exchange rate regimes would fit this pattern. The considerable contributions to this literature by Canadians, among others, do not, however, usually distinguish direct investment from other capital flows and therefore are not directly relevant to this review. One exception is the studies showing that direct investment required much less adjustment in the balance of payments than did portfolio investment and under average conditions was fully accommodated through automatic income adjustments (Reuber, 1973; Caves and Reuber,

1971).[10] Another is the literature on transfer pricing noted in Chapter 2.

As noted earlier, Levitt has raised a fundamental question about the negative effects on entrepreneurship as a result of a continued substantial reliance on foreign investment. The point is of obvious importance given the decision-making role of entrepreneurs in the economic sphere and their influence beyond it. Studies on this theme were discussed in the second section of Chapter 3. It is worth emphasizing that a significant social science literature along these lines has developed in Canada, often involving a broader critique of Canadian capitalism. Some of it uses the staple thesis of Innis as a form of dependency theory. For example, Naylor (1972, 1975) has argued that the ease and nature of capital imports meant there was little pressure to develop policies and institutions appropriate to domestic industrial development. In particular, he believes the dominant group of Canadian capitalists remained a mercantile-financial group associated with servicing staple development and with the perpetuation of colonialism and underdevelopment. Clement (1977) has brought a sociological perspective to bear on this issue by examining in considerable detail the backgrounds of and links between those who run the major corporations in Canada and in the United States, links dominated by the MNE. He draws a contrast between the connections forged historically by financial institutions with industry in the United States, but with commerce in Canada, with a consequent inability of Canadians to contribute fully to the development and ownership of manufacturing and natural resources. Both studies develop themes of exploitation of the other parts of Canada by business groups in Ontario. Richards and Pratt (1979) have, however, challenged these themes of dependency on foreign capital and on eastern business interests. In analyzing mineral development in Alberta and Saskatchewan they point to the strong entrepreneurial role of provincial governments as well as a vigorous private sector (often allied to the state) in Alberta especially.

Some writers have examined the MNE in the context of the wider set of relations between Canada and the United States. Through geography, investments, trade, communications, military alliances and population flows, Canada is linked closely to an economy and a society

that have significant influence on the modern world. Canada has responded to the challenge of proximity to the United States in many ways, three of which are of interest for present purposes.

The first is an attempt to define or to redefine the bases of the Canadian state. Such efforts have their roots in many sources: socialists who see the need to nationalize or to regulate closely the large corporation in general and the MNE in particular; those who, following Karl Polanyi, Jacques Ellul and others, want to control the effect of technological change on society; still others, following J.K. Galbraith, who favour a higher degree of planning by the state in conjunction with private sources of power. Those who might be included in such groups clearly would differ on many points. In the Canadian context, there is a common desire to regulate and, in part, to supplant the market in order to effect social and economic change through a reassertion of the power of the state. That power could be expressed in various ways, of course, some of which are more centralist and bureaucratic than others. Insofar as such views are directed at a market dominated by oligopolistic MNEs, as they generally are in Canadian writing, the views often reflect Canadian nationalism.[11]

Second, Canada protects Canadian cultural activities, including forms of communication, from the penetrative powers of US activities. Foreign takeovers in these areas have long been resisted, and Canadian legislation has led to serious conflicts between Canadian and US governments and interest groups (Litvak and Maule, 1974). Most such cultural activities are now treated as key sectors by federal and provincial governments, with subsidies for domestic activity and limitation or prohibition of foreign ownership and entry.

Third, Canada is slowly addressing the problems created by the extension of US law and policy to Canada through the parent-subsidiary tie. Some of the more important cases involved the US Trading with the Enemy Act, the application of anti-trust decisions to companies in Canada, and the application in the 1960s of US balance of payments guidelines to subsidiary operations abroad. The Canadian public reacted strongly to the erosion of sovereignty, but because of the complexity of the issues and the strength of the views of the US government at the time, little has been resolved. Some of the frictions have been

modified as circumstances changed (for example, with the US recognition of China), but the issue continues to smoulder in anti-trust and other areas (Government of Canada, 1968, Chap. 7; Leyton-Brown, 1974; Thomas, 1983).

Some writers have taken a different view of the effects on Canadian political and cultural development of close economic linkage with the United States. Doran (1983) observes that an index of Canadian economic capability has increased substantially relative to the United States throughout this century, especially since 1950. The measure used is also positively correlated with economic interdependence with the United States. Economic interdependence does limit distinctive cultural development, but does so selectively, depending on how such development is measured.

A number of Canadian economists would define some of the policy issues raised here and in Chapter 5 mainly in terms of protectionism. Although they would not deny that protectionism under certain conditions can raise real income (as well as serve non-economic purposes), their view of the imperfections of the political process suggests it is more likely to redistribute income. Breton (1964) and Johnson (1965) gave the strongest early statements of this view. Nationalism is regarded as a collective consumption good that can give both general and particular benefits. The particular benefits are real income or better jobs and tend to be received mainly by skilled persons; general benefits in the form of psychic income reach everyone. The political process then involves persuading those who lose real income to accept such policies because of the gain in psychic income. Both the theory and the testing underlying this model have been criticized by Watkins (1978) who challenges the conclusion that nationalism redistributes real income and especially that it reduces total income. By contrast, Migué (1979) has used the model and economic analysis more generally to explore a variety of nationalist policies for Canada and Quebec, concluding that in both cases particular groups receive benefits at the expense of the majority.

It is somewhat surprising that more attention has not been paid to the effects on income distribution both of MNE activities and of related public policies. The neo-classical models used in theory and

measurement (for example, MacDougall, 1960, and Helliwell and Broadbent, 1972) conclude that labour is a major gainer. Burgess (1978) shows, however, that direct investment tends to be sector specific and that much national output is not traded. Using a model highlighting these features, he demonstrates that the traditional conclusion does not necessarily follow. The loss by labour in his model comes about because foreign direct investment is unable to enter the sector of non-traded goods, a situation more likely when governments restrict entry to some sectors by foreign direct investment.

Finally, it is interesting here to note an important link to trade policy. Bhagwati and Brecher (1980) have pointed out that the argument for welfare improvement from trade liberalization implicitly assumes domestic ownership of the factors of production. If foreign ownership exists, it can be shown that trade liberalization, by shifting domestic income from resident to non-resident owners, can reduce the income of domestic labour and capital. Burgess (1980) has argued that, in a small, open economy rich in resources, protection can increase foreign investment in both the protected and the unprotected sectors and raise real wages. Losses are imposed on the ownership of natural resources, but labour and capital can gain. If such resources are held by foreigners, they are the losers from protectionism, not the residents. These and other writings qualify traditional conclusions on trade policy or at least point out the need to consider accompanying policies to offset the effects on income distribution. They also are related to some of the arguments in the second section of Chapter 2, on the taxation of MNEs.

5: OTHER POLICY STUDIES

Many policy issues and studies were discussed in the previous chapters. In this chapter, I will consider more general policy studies as well as the research on two major policies, the Foreign Investment Review Agency (FIRA) and the National Energy Program (NEP).

Foreign control of Canadian industry became an issue as a result of the hearings of the Royal Commission on Canada's Economic Prospects (Government of Canada, 1958). Walter Gordon, the influential chairman of the Commission, has contributed significantly to the subsequent development of policy. Of a variety of reports for governments, two for the Government of Canada are worth particular mention. Foreign Ownership and the Structure of Canadian Industry (Watkins Report, 1968) emphasized the problems created by inappropriate Canadian industrial policies and by the large oligopolistic firm operating across national boundaries. It recommended policies designed especially to increase the net benefits of foreign ownership, to increase Canadian capacities for undertaking investment, and to cope with extra-territorial extension of US law. Foreign Direct Investment in Canada (Gray Report, 1972) also reviewed some of this ground and went on to consider at length various policy alternatives. A central point in the report is the idea of truncation. This concern led to the recommendation of a review agency designed to increase the net benefits to Canada from inward direct investment. It is noteworthy

that neither report recommended major efforts to purchase foreign-owned firms and, indeed, were somewhat critical of such purchases.[12] In different ways, the emphasis was still on the performance of foreign-owned firms, the improvement of Canadian investment capacities, minority share issues, the designation of key sectors usually outside the areas of concentration of MNEs, and resistance to extra-territoriality in particular. Nationalist groups pressed throughout the 1970s for much stronger emphasis on buying foreign-owned firms (Gordon, 1975; Rotstein and Lax, 1974). Governments moved only gradually and selectively in this direction, usually pursuing several objectives by such means. In the National Energy Program, however, a systematic attempt was begun to increase Canadian public and private owership of this major sector of industry.

Federal and provincial governments today have a wide variety of policies in response to the extensive foreign ownership of industry. Key sectors have been declared where foreign ownership is limited or excluded. The establishment and merger of foreign-owned firms is reviewed. Many policies of both federal and provincial governments distinguish between firms by ownership after entry to Canada. These are described at length in the FIRA study of Canadian legislation affecting foreign investment in Canada (1977, 1978). A study published by the United Nations of regulations of transnational corporations contains a brief, recent outline of Canadian policies (1983, 293-315).

Two policy approaches are so far-reaching that the literature on them deserves specific comment. The Foreign Investment Review Act was a direct outcome of the Gray Report. The Foreign Investment Review Agency established under the Act, and responsible to a minister, formally reviews takeovers by already existing foreign-owned firms and by those that are located abroad, expansion by existing foreign-owned firms into unrelated lines of activity, and the establishment of all but the smallest new foreign-owned firms. It does not, however, review the major activity of such firms, their expansion (except by merger or by a change of parent company) in their existing lines of business. In 1980 the government announced plans to allow FIRA formally to advertise intended takeovers by foreign-owned firms, to subsidize competing bids by Canadian owners, and to monitor the

performance of existing foreign-owned firms. These plans were set aside a few years later in the midst of the debate over the National Energy Program. Through 1983 the Agency's operations have been substantially altered to clarify its bases for decisions and to simplify and speed up its procedures. One result has been a significant decline in the rate of rejection of applications.

The operations and effects of FIRA are much discussed and often criticized but little studied in any depth. Abdel-Malak and Sarkar (1977) have argued that the guidelines under the Act could introduce biases in favour of more diversified firms, foreign investors already in Canada, and the wealthier provinces. Skeoch and McDonald (1976, 93-112) have argued that the evaluation of foreign mergers should be the same as for domestic mergers. Rugman (1977) concluded that the evidence to date suggested that FIRA was not particularly restrictive, that this was desirable given the contribution MNEs can make to growth, and that there are better ways to attack the entry barriers that give monopolistic advantages to MNEs. In a review of the Agency's operations, Calvet and Crener (1979) emphasized the reactions of different types of firms to a control system and the need to integrate policy in this area with industrial policy more generally.

Globerman (1979) undertook a thorough analysis of FIRA's direct and indirect effects on national income in a study of the effects of foreign direct investment generally. He concluded that the effects of FIRA are complex and difficult to quantify. While the intention of FIRA is to assure significant benefits, he believes there are grounds for the view that it reduces wealth and redistributes income to higher-income groups.

MacDowall (1984), using a questionnaire survey, noted that 11 per cent of the foreign firms that had seriously considered investment in Canada claimed to have been deterred by foreign investment controls. Schultz et al. (1980) provide a detailed critique of policy design, especially of the failure of the Cabinet to establish clear policy guidelines. They argue also that the processes of approval are too bureaucratic and that the Cabinet is not accountable to Parliament in individual cases—in brief, "political control without meaningful effect and decision-making without answerability" (p. 158). In Beckman's

interview study (1984), half of the firms claimed that FIRA hindered investment plans by delays and by apparent rigidity, among other ways. These were mainly larger firms or those in sectors considered sensitive.

As noted earlier, these concerns have been addressed to some extent in recent years. It should be added that the recent easing of the Agency's rules is not universally welcomed. Some critics argue that the rules need to be strengthened to give greater emphasis to reducing foreign ownership and control. At present, the degree of participation by Canadians (as managers, directors, owners, etc.) is only one of the five broad factors of assessment of significant benefit and is not necessarily the decisive factor in particular cases or overall.*

The other recent major policy development has been in the energy industry. Through the 1970s the federal government had made some important moves in this industry, including the establishment of Petro Canada and the Petroleum Monitoring Agency. The National Energy Program, announced in October 1980, had many objectives. Of interest for present purposes are the objectives of increasing Canadian ownership of oil and gas production revenues from 28 per cent to 50 per cent by 1990 and of securing greater Canadian control of the industry, including a significant expansion in public ownership.[13] Petro Canada or other entities were to buy 'one or several' MNEs, with financing provided by a special energy tax. Most incentive payments for exploration and development expenditures on provincial lands, as well as the larger incentives for work on federally controlled lands, are geared to the degree to which the payee is Canadian-controlled. A Canadian ownership test must be met also at the production stage on federal lands. Legislation also provides for a 25 per cent Crown

* After this study was completed, the Government of Canada introduced the Investment Canada Act, which is to replace the Foreign Investment Review Act. Under the former, review will no longer be required for new investments or for acquisitions of firms with assets under $5 million, except in sectors considered culturally sensitive. Larger acquisitions will continue to be reviewed, but the minister involved will be authorized to make decisions under firm deadlines and clearer rules for deciding the status of companies.

interest in all petroleum rights for all companies on federal lands, with some ex gratia payments for work done to date.

The federal government's reasons for this approach are given in the National Energy Program (1980) and in the budget papers that followed. The basic argument was that the major planned price increases in a largely foreign-owned industry, combined with the existing system of depletion allowances available to all firms but used mainly by MNEs, would mean rents would go largely to the foreign-owned sector. In addition, the government favoured more domestic control of the industry, as distinct from ownership, in order to more easily set the direction and speed of development and to assure greater use of domestic supplies and more research and development.

The flood of public discussion on the NEP cannot hide the fact that substantial research on many of the issues, including those which were legislated, is conspicuous by its absence.[14] One reason for this may be that the government decided to conduct its studies internally as part of a budget process, which, in Canada, involves secrecy until the budget is announced. This is in contrast to the Watkins and Gray Reports where participation by non-governmental researchers and extensive public debate took place before policies were introduced.

Perhaps with time these aspects of the NEP will receive more attention. For the present, we can note a number of articles that have explored the costs of the repatriation effects of the NEP. Daly (1981) has estimated the direct monetary costs of the repatriations to 1990 and has explored the effects on the balance of payments and on technology transfers, and the question of who benefits. Sultan (1982) has considered the incentives to repatriation in the NEP and emphasized the monetary and balance of payments costs. The effect of the NEP and of criticisms of FIRA on Canadian-US relations are explored in articles by Wonder (1982) and by Hufbauer and Samet (1982). These authors emphasize the concerns of the US government about discrimination in trade and investment both in terms of the reactions of the executive and congressional branches and the effects on international treaties. The latter paper analyzes corporate reaction in the United States as well and goes on to examine the regulation of foreign direct investment in the United States. Clarkson (1982) has

examined at length the sources of the increased bilateral stress that developed between Canada and the United States in the early 1980s over NEP and FIRA and in several other major policy areas. He concludes that this period marked a fundamental transformation towards continuing crisis in the bilateral relationship and considers the various elements of a strategy to deal with this.

Other aspects of policy have received limited attention. A comprehensive statement of the various attitudes of Canadians towards foreign direct investment in the late 1960s and early 1970s can be found in Fayerweather (1973). He also considers the reasoning underlying FIRA and later policy approaches as well as the processes of decision making behind such policies. Fayerweather (1974) also studied in depth the attempt by Canada to prohibit foreign-controlled commercial banks, specifically the Mercantile Bank. Murray (1975, 1981) has done a series of studies on Canadian attitudes towards foreign ownership. Although there have been some short-term swings, in the main the studies show an increasing concern over time with the negative effects of foreign control of Canadian industry. They also show consistently, however, that the issue ranks far below such problems as inflation, unemployment and environmental concerns. Safarian (1978, 1983a, b) has provided details of policies in the more developed countries directed at limiting or influencing MNEs. All such countries have sectors that are partly or wholly closed to foreign ownership, and many have some form of review process (often less formal than in Canada), discriminatory treatment after entry, and incentives designed partly with a view towards their effect on MNEs. He has argued that regulatory methods frequently fail to achieve their objectives at the national level, or do so with significant domestic costs, and often impose such costs on other countries.

CONCLUSIONS

In recent years, a much larger group of Canadian economists incorporated research on foreign direct investment into their work and did so with greater precision of analysis. Nevertheless, some important gaps in knowledge remain.[15] Canadian economists, like those elsewhere, have not resolved the issue of the national welfare effects of the MNE. Public thinking in Canada (including the conclusions of some economists) tends to a view that the long-term developmental effects may be negative. Most economists who have written on the subject, however, believe either that welfare effects depend on the circumstances or that MNEs bring net economic benefits. Both the macro-economic and micro-economic effects are complex and require more precise theoretical and empirical work.

One question, which internalization theory suggests is central, is at times forgotten in both research and policy in Canada. To what extent and in what sectors can domestic firms, contracts and markets substitute for the MNE? If one decides to develop local firms as substitutes, in which sectors can they be developed most efficiently? It is difficult to know how an agency such as FIRA, or other approaches to foreign ownership and industrial policies more generally, can be effective without more such research. One can readily understand the difficulties in answering this question given the importance of the responses of private and public entrepreneurs to the challenges posed

and the complications involved in assessing such responses.

Somewhat surprisingly, there has been relatively little systematic analysis of the effects on income distribution both of foreign direct investment and of policies directed at such investment. This includes regional as well as personal income distribution, each of which usually plays a large role in policy making. The literature on the social and political aspects of MNEs is quite underdeveloped, both by economists and by other social scientists in Canada. Too many of those who write on these aspects are either unprepared to step out of their particular discipline or, when they do, forget the meaning of discipline entirely.

Obvious specific weaknesses must be tackled both in analyzing the effects of direct investment and of MNEs and in assessing alternative policies–for example, in balance of payments effects, on issues in the natural resource sector, and on transfer prices. Very few studies exist of the increasingly important phenomenon of outward direct investment and Canadian-owned MNEs.

In a country with a long history of foreign ownership, and some three decades of active public discussion and policy development, more might have been expected of economic analyses of policy. A long list of specific policy initiatives, including FIRA, has drawn little analytical response from economists. One is hard put to find serious studies on the economics of repatriation, optimal taxation policies, and the probable response of MNEs to trade liberalization, to mention just a few issues. Nor is it clear that economists need leave such difficult issues as extra-territorial extension of law and policy mainly to lawyers and political scientists.

An institution as important as the MNE, especially to Canada, will be linked inevitably with major issues of the day. Three issues overlap in the government response to MNEs, namely, those of private versus public enterprise, of national versus multinational policy approaches, and of central government versus provincial government responses. The MNE has raised sharply the issue of government regulation or ownership of the large corporation, extending, as the NEP and other examples of repatriation have shown in Canada, to increasing the public sector and not only the Canadian-owned sector. National policies on MNEs have often been geared to securing more of the industrial net benefits at the

expense of other countries, by review on entry and by attempts to control the effects of such firms. Provincial governments have been quick to emulate some aspects of the federal government's policies towards direct investment and MNEs, to preserve their constitutional powers as well as to provincialize potential benefits. These issues certainly have not been absent from the analysis of the interplay between governments, MNEs, national companies, and other groups. They deserve more analysis as governments everywhere attempt to deal with MNEs, both those controlled abroad and the increasing number controlled at home.

NOTES

1. Hymer, it may be noted, had tended to emphasize explicitly only the pecuniary interdependence among firms. The McManus articles of 1972 and 1975 mentioned here derive from McManus (1971). It is a curious footnote to the history of this topic that neither person published his very innovative doctoral theses on this subject, although Hymer's was published posthumously.

2. In Chapter 3 a third view will be discussed, namely that the presence of many MNEs over long periods has deleterious economic effects.

3. For evidence on these effects, see Caves (1974b), Globerman (1979a) and Wilkinson (1982) in Chapter 3.

4. A number of papers presented at a conference organized by A.M. Rugman at Dalhousie University late in 1983 contributed significantly to understanding transfer pricing in developed and developing countries.

5. See Safarian, 1973, 429-30 for a comment on such interpretations.

6. Here, as elsewhere, I am speaking of average results and of the

weight one gives to the MNE in relation to other determinants of any outcome. It is always possible to find a variety of causes and a distribution of particular cases.

7. Gorecki (1980) argued, however, that data for the food-processing sector suggest diversification for domestic firms can be explained by Canadian market factors while diversification for foreign-owned firms is related to the parent's home market.

8. These findings are not inconsistent with the results in many developing countries where protracted protection and foreign direct investment yield low or negative social welfare outcomes. See Lall and Streeten (1977), for example.

9. Based on a Council analysis of 1,382 technology transfers by US-based firms in the years 1950-1978, from the Multinational Enterprise Project data at Harvard University. See Economic Council (1983), 53-5.

10. The studies by Reuber (1973) and Caves and Reuber (1971) also suggested that the effect of foreign direct investment on domestic investment was strongly positive (that is, the former did not simply substitute for the latter), although later and fuller estimates by Van Loo (1977) suggest that the effect is smaller than originally estimated. Goldsborough's conclusion about adjustment, noted in the second section of Chapter 3, is also relevant.

11. In addition to works noted earlier in this chapter, Rotstein (1973), Grant (1969) and several of the essays in Russell (1966) are also relevant. Galbraith, it may be noted, has generally disassociated himself from the nationalist critique of the MNE.

12. For example, pp. 431-32, Chap. 12, Gray Report (1972).

13. These figures are based on ownership of production revenues. Much higher Canadian ownership results if ownership of reserves, transmission and distribution are included.

14. It should be emphasized that this comment refers to issues related to foreign ownership and control. Canadian economists have long studied the natural resource sector, including energy. The various studies by John Helliwell and his colleagues on how energy policies affect the distribution of rents is one important example. Helliwell et al. (1984) break out the distribution of rents by domestic and foreign owners and suggest that the prices paid for repatriation of firms were too high to allow an (assumed) real alternative return of 7 per cent.

15. Several aspects of MNEs and of developing countries were touched on in this study in outlining the literature on the major themes. There does not appear to be a great deal of study of this topic by Canadian writers. Some major works are those by Helleiner, already referred to, that cover the effect of MNEs on the trade and development of the developing countries, among other topics; a series of studies by Litvak and Maule, partly covered earlier, including case studies of Canadian direct investment in the developing countries; a comprehensive theoretical and empirical study by Reuber et al. (1973) on the effects of MNEs in developing countries; empirical studies by Lecraw of the performance of MNEs, including choice of technology, notably in Thailand; studies by Langdon of performance particularly in Kenya; a study of MNEs in relation to the Andean Pact by Mytelka; and a review by Adams of policy issues facing Canada.

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